Todd F. Silbergeld
Director-
Federal Regulatory

SBC Communications Inc.
1401 I Street, N.W.
Suite 1100
Washington, D.C. 20005
Phone 202 326-8888
Fax 202 408-4806

November 14, 1996

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Federal Communications Commission
Office of Secretary

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: *Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149*

Dear Mr. Caton:

In accordance with the Commission's rules governing ex parte presentations, please include in the official record in above-referenced rule making docket the attached Affidavit of William E. Taylor and Paul B. Vasington prepared on behalf of SBC Communications Inc.

The purpose of the affidavit is to describe how some of the Commission's recent rules on local competition and its proposed rules for regulatory safeguards, as they both relate to joint marketing, are inconsistent with the requirements and intent of the Telecommunications Act of 1996, and how implementation of the proposed rules would prevent consumers from receiving the full benefits of "one-stop shopping" for telecommunications services.

Pursuant to the Commission's rules, an original and two copies of this letter and the attachment are provided. Please stamp and return the copy provided for that purpose. Should you have any questions concerning this filing, do not hesitate to contact me at (202) 326-8888.

Sincerely,

Todd F. Silbergeld

Attachment

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List ABCDE

NATIONAL ECONOMIC
RESEARCH ASSOCIATES
ONE MAIN STREET, CAMBRIDGE, MASSACHUSETTS 02142
TEL: *617.621.0444* FAX: *617.621.0336*

Consulting Economists

AFFIDAVIT OF WILLIAM E. TAYLOR AND PAUL B. VASINGTON

Prepared for SBC Communications Inc.

November 14, 1996

AFFIDAVIT OF WILLIAM E. TAYLOR AND PAUL B. VASINGTON

I. QUALIFICATIONS

A. William E. Taylor

1. My name is William E. Taylor. I am a Senior Vice President of National Economic Research Associates, Inc. (NERA), head of its telecommunications economics practice and head of its Cambridge office. My business address is One Main Street, Cambridge, Massachusetts 02142. I have been an economist for over twenty-five years. I received a B.A. degree in economics, *magna cum laude*, from Harvard College in 1968, a master's degree in statistics from the University of California at Berkeley in 1970, and a Ph.D. in Economics from Berkeley in 1974, specializing in industrial organization and econometrics. I have taught and published research in the areas of microeconomics, theoretical and applied econometrics, and telecommunications policy at academic institutions (including the economics departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology) and at research organizations in the telecommunications industry (including Bell Laboratories and Bell Communications Research, Inc.). I have participated in telecommunications regulatory proceedings before state public service commissions and the Federal Communications Commission ("FCC" or "Commission") concerning competition, incentive regulation, price cap regulation, productivity, access charges, pricing for economic efficiency, and cost allocation methods for joint supply of video, voice and data services on broadband networks.

B. Paul B. Vasington

2. My name is Paul B. Vasington. I am a Senior Analyst with NERA. My business address is One Main Street, Cambridge, Massachusetts 02142. I received a B.A. degree in political science, *magna cum laude*, from Boston College in 1989, and a master's degree in public policy from Harvard University's John F. Kennedy School of Government in 1991. Prior to joining

NERA earlier this year, I served as Director of the Telecommunications Division at the Massachusetts Department of Public Utilities (MDPU) from 1992 to 1996, and before that I was on the staff of the MDPU. At the MDPU, I supervised investigations into rate-rebalancing, local competition and interconnection, competitive pricing, and price cap regulation, among others. Since joining NERA, I have worked on issues related to implementation of the Telecommunications Act of 1996, electric industry restructuring, telephone company mergers, and interconnection pricing.

II. PURPOSE OF AFFIDAVIT

3. The purpose of this affidavit is to describe how some of the Commission's recent rules on local competition and its suggested rules for regulatory safeguards as they both relate to joint marketing are inconsistent with the requirements and intent of the Telecommunications Act of 1996, and how implementation of the proposed rules would prevent consumers from receiving the full benefits of one-stop shopping for telecommunications services.

III. BACKGROUND

4. The ability to bundle and sell in one package a full panoply of telecommunications services is quickly becoming a crucial asset for companies who hope to succeed as telecommunications markets become more competitive and services more complex. For example, MCI recently has been heavily marketing service packages called "MCI One," with the motto "One company, one number, one box, one bill. It's that simple."[1] AT&T also has announced its own package of services called "AT&T.ALL."[2] Also, the importance of one-stop shopping is seen as a factor behind recent telecommunications mergers, such as those announced between British Telecom-

[1] MCI indicates in its advertising that "[o]nly MCI One offers you all of today's communications options - calling, cellular, paging, Internet, and e-mail - and wraps them together in one convenient package." http://www.mci.com/mcione/indexabout.shtml (November 5, 1996).

[2] "Following MCI's lead, AT&T launched a new service to provide business customers with a one-stop shop. The service, called AT&T.ALL, provides features such as one-stop customer care and consolidated billing to businesses subscribing to AT&T long distance and a wide array of AT&T services and calling plans." "AT&T Joins Full-Service Trend," X-Change, November 1996, page 29.

MCI and WorldCom-MFS.[3] Consumers clearly are demanding one-stop shopping for communications services, and in order that consumers may benefit from the highest quality bundle of services at the lowest prices, all carriers must have the capability of packaging and marketing these services together.

5. The largest telecommunications carriers in this country until recently have been unable to offer packages of the full range of telecommunications services. Interexchange carriers (IXCs) generally have not been able to include local exchange service in their packages over a wide geographic area, and Bell operating companies (BOCs) are still restricted from offering in-region interLATA services. However, in the Telecommunications Act of 1996 (Act), Congress set forth the process and conditions that will enable BOCs and BOC affiliates, interexchange companies, and others, to market a full array of services. Under the terms of the Act, IXCs and competitive local exchange carriers will be able to offer local exchange services by using their own facilities, reselling the incumbent local exchange carriers' (ILECs') services, or combining their own facilities with the incumbent's unbundled network elements. And BOC affiliates will be allowed to offer interLATA service after the BOC meets stringent requirements in the Act related to local interconnection and regulatory safeguards, including a requirement that a separate affiliate provide interLATA service for at least three years.

6. The Act expressly provides that a BOC and its interLATA affiliate may jointly market local and interLATA services in two different ways. First, the interLATA affiliate may jointly

[3] "The big fight for long-distance customers in the U.S. has largely given way to a battle by carriers over which will be the first to offer a bundle of local, long-distance, wireless and Internet services all on the same bill." John J. Keller "BT-MCI Merger Reshapes Telecom Industry," Wall Street Journal, November 5, 1996, page B1.

"This [merger] will make the new firm, MFS WorldCom, the first American telephone company since AT&T's breakup in 1984 to offer customers every sort of telephony: local, long-distance and (since this is 1996) Internet access. One-stop shops are said to represent the future of the telecoms business." "Two Davids Join," The Economist, Vol. 340, No. 7981, August 31, 1996.

market the BOC's local exchange services, as long as other carriers also may market[4] and sell the BOC's local exchange services. Second, the BOC may jointly market the interLATA affiliate's services when that affiliate is authorized to offer such services. In addition, the Act provides certain affiliate transaction rules that presumably would apply to the BOC's joint marketing arrangements with its affiliate.

7. All other telecommunications carriers also are allowed to provide one-stop shopping, but large IXCs (i.e., those who serve greater than five percent of the presubscribed access lines in the country), in areas served by BOCs, are restricted from jointly marketing their own long-distance service in combination with a BOC's local exchange service purchased by the IXC from the BOC for resale under section 251(c)(4) of the Act. This restriction lasts only until the BOC also has the capability, through interLATA entry, to offer customers a joint service package, or until 36 months after the passage of the Telecommunications Act, whichever is earlier. It is important to note that the Act's joint marketing constraint on large IXCs is itself far from a prohibition. IXCs may, at any time, jointly market their interLATA service with local services provided wholly over their own facilities or provided through a combination of facilities and the BOC's unbundled network elements. Therefore, Congress's effort with this constraint on large IXCs to level the playing field still tilts the field away from the BOCs.

IV. ANALYSIS

8. The FCC has recently issued, inter alia, final rules concerning the availability of unbundled network elements, and has suggested affiliate transaction rules as they relate to BOC joint marketing. In our opinion, implementation of these rules in a one-stop shopping environment would further tilt the playing field away from the BOCs and undermine the procompetitive intentions of the Act. First, the Act's joint marketing resale restriction for the large IXCs would be rendered meaningless by the FCC's conclusion that carriers who do not supply their own local exchange services can purchase unbundled network elements and combine these elements

[4] Marketing should be interpreted to include post-sale activities, such as single point-of-contact and a single bill.

into a local exchange service offering. Second, in terms of affiliate transaction rules, the FCC suggested—and some BOC competitors not surprisingly recommended—that the BOC and its affiliate should be required to jointly contract to an "outside marketing entity" for joint marketing of interLATA and local exchange service, which would impose an expensive and unnecessary burden on the BOCs' joint marketing activities.

A. Joint Marketing Restriction for Large IXCs

9. The Act provides different requirements and pricing standards for unbundled network elements and resale of existing retail services.[5] As noted above, however, the joint marketing restriction on large IXCs applies only to the resale of the BOC's local services pursuant to section 251(c)(4) of the Act. Because even the largest IXCs are not expected to deploy their own local exchange facilities over a widespread area prior to BOC interLATA entry, the application of the large IXCs joint marketing restriction only to resale of BOC local services indicates a Congressional desire to prevent the BOCs from being put at an immediate competitive disadvantage, relative to their biggest competitors, during the period before the BOCs are allowed into the interLATA market.

B. Affiliate Transaction Rules for BOC Joint Marketing

10. Because the Act prohibits BOCs and their affiliates from having common employees, the Commission suggests that it may require the BOC and its affiliate to jointly contract with an "outside marketing entity" for joint marketing of interLATA and local exchange service. We believe that this conclusion is not necessary to fulfill the Act's requirements and that it would in fact be harmful to consumers because it would impose an expensive burden upon the BOCs for no apparent reason and with no corresponding benefit to anyone but the BOCs' competitors.

11. The Act requires that a BOC and its affiliate have separate employees. The Act does not prohibit the sharing of services and functions between affiliates, and marketing clearly is a

[5] See sections 251(c)(3)-(4) and 252(d)(1) and (3).

service. And from an economic perspective, this is the type of sharing of functions to preserve economies of scope for which the separate affiliate structure was designed. Joint marketing transactions between a BOC and its affiliate must satisfy the Act's requirement that all such transactions be conducted at "arm's length," which simply means that marketing services provided by the BOC to its affiliate, and vice versa, must at least cover costs, with any such transactions reduced to writing and available for public inspection. Any other restrictions on BOC joint marketing would be both superfluous and harmful.

12. The suggestion that a BOC and its affiliate be required to use a third-party marketing entity for joint marketing appears to rest on the assumption that if a BOC markets its own services and the services of its affiliate together, the BOC's marketing employees somehow become "shared" between the BOC and the affiliate. Under this logic, however, even the joint contracting of an outside marketing entity would be prohibited because those employees doing the contracting would then be shared between the contracting parties. Clearly the Act's requirement for separate employees does not prohibit BOCs and their affiliates from providing Congressionally-authorized services to each other. We believe that the Commission should allow BOCs and their affiliates to market each other's services, subject only to the Act's "arm's length" requirement for such a transaction.

13. It may be argued that requiring the use of a third-party marketing entity for joint marketing is a harmless competitive safeguard, but this is certainly not the case. First of all, such a requirement is superfluous as a competitive safeguard, since the Commission's existing affiliate transaction rules, coupled with the straightforward requirements in the Act, are sufficient to prevent anticompetitive abuses. Second, if it is more efficient for a BOC and its affiliate to use a third party for joint marketing they will do so absent the Commission's requirement. If not, they should be free to take advantage of whatever efficiencies they derive from using their in-house marketing organization. Customers demand one-stop shopping for communications services, and they will benefit from the lowest possible prices for their packages of services only if companies are allowed to account for the unique efficiencies that each brings to the

market. Unnecessarily raising the costs of a major supplier, such as the BOCs, by requiring them to use a third party to provide a service when it is more efficient for them to provide the service in-house ultimately will raise prices paid by consumers, contrary to the goals of the Act.

V. SUMMARY

14. One-stop shopping for communications services clearly is the prevailing strategy, as evidenced by recent developments in the telecommunications industry, and the Telecommunications Act of 1996 sets the stage for all carriers to be able eventually to offer a full range of telecommunications services. In implementing the requirements of the Act, the Commission should ensure that the BOCs are allowed to market and sell the type of bundled service packages that MCI and AT&T are currently offering.

15. The Act places some restrictions on BOCs and large IXCs in the transition period, in order to ensure that one group of competitors does not have an immediate competitive advantage over another. The restrictions in the Act alone make it somewhat easier for large IXCs to jointly market interLATA and local services, but the Commission's recent suggested and actual rules tilt the playing field even farther away from the BOCs than was intended by Congress. In order to make certain that customers receive the highest quality bundle of services at the lowest possible prices, the Commission should ensure that the Act's intended symmetry in terms of large IXCs and BOCs offering one-stop shopping in competition with each other is given the effect that Congress intended, and the Commission should not supplement the Act's provision related to BOC joint marketing transactions with additional, unnecessary, and potentially costly rules and requirements. To do otherwise certainly would be harmful to the BOCs, but, more importantly, it would hinder the competitive process in delivering the Act's intended goal of lower priced services offered in the manner that customers desire.